

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NO PROTEST REC'D
8/31/99

Release Copies to District

Date: JUL 29 1999

Contact Person:

ID Number:

Telephone Number:

CLOSED

9-14-99

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Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated as a non-stock, non-profit corporation in [REDACTED] on [REDACTED]. Your Articles of Incorporation stated your purposes as:

to raise funds through various investments and business opportunities with the net income being generated by such investments and activities to be distributed to fire departments, rescue squads and other agencies involved in the saving of endangered lives, and any and all acts allowed corporations by the [REDACTED]

These Articles were amended on [REDACTED] to add to the above paragraph the following sentence:

The purposes for which the corporation is organized are exclusively religious, charitable, scientific, literary, and educational within the meaning of section 501(c)(3)

...
Your by-laws limit your voting membership to 15. Membership is perpetual. Once accepted, the individual's membership continues until the person resigns, dies or fails to abide by the rules of the organization and is dropped from the roll for infractions. To be eligible for membership, an individual must be sponsored by two members of the corporation. Your Charter

[REDACTED]

appoints as initial directors (members), [REDACTED], [REDACTED], and [REDACTED]. Your members elect the officers which serve as your Board of Directors. On your Form 1023, you list your current officers and directors as [REDACTED], President, [REDACTED] Vice President, [REDACTED], Secretary/Treasurer, and [REDACTED], [REDACTED], [REDACTED] and [REDACTED] as directors. [REDACTED] is employed full-time as the banquet hall manager.

Your application indicates that you do not plan to solicit charitable contributions. Your initial funding is to come from a \$[REDACTED] loan at 7% interest for a 16 year term from the [REDACTED] for start up costs. You also list a mortgage with [REDACTED] in the amount of \$[REDACTED] at 7% payable in 15 years. The remainder of your funding is to come from providing catering services to the public. Your estimated budget lists your sources of support as hall rental fees, food service profit, bar service profit, dances, nitorial fees, bartender fees, and in-house rentals. Eventually, you also plan to operate bingo games.

You purchased a building on [REDACTED], that was previously operating as the [REDACTED]. The building was built in [REDACTED] and foreclosed on by the bank. You bought the hall and all contents for \$[REDACTED]. You estimate that building and furnishing a similar facility would have cost approximately \$[REDACTED]. You renamed the hall [REDACTED] and will use the building as your base of operations. You charge fees for events held at the facility. Fees will vary depending on the type of event, the menu selection, beverage service, and the number of guests. You indicate that you purchased the banquet hall as an investment because it is a business that will generate money for charity.

On [REDACTED], you entered into a two year contract with [REDACTED] a commercial firm, to operate the catering business. [REDACTED] is to receive 77.5% of the gross food bill as its compensation. You contract directly with the customers and guarantee the compensation to [REDACTED].

On [REDACTED] you applied for and were granted a Certificate of Registration of True Name to transact business in [REDACTED] under the name [REDACTED] and have been in operation since that time. You state on Form 1023, Part II that you are renting out your facility for catered events such as wedding receptions, graduation parties, corporate meetings, and trade shows. You hold a liquor license and a beer license. You also plan to apply for a bingo license and hold super bingo and raffle events once you obtain tax exemption. Any money received in excess of normal operational expenses will be donated to charity.

Although you have been operating since [REDACTED] you have donated no funds to charity. You have indicated that all income over and above operational expenses and a reasonable reserve for future expenses will ultimately be distributed for charitable purposes but that you have not made enough profits to both insure the viability of the business and make charitable donations.

By letter of [REDACTED], you amended your application to indicate that your building will be used for the following additional purposes:

1. by volunteer fire departments to conduct public safety courses;
2. by volunteer fire departments for the purposes of training their members;
3. by other non-profit organizations for fund-raising and non-fund-raising activities;
4. by volunteer fire departments to operate bingo games;
5. by non-profit organizations to conduct informational and membership meetings;
and
6. by the general public for receptions, parties, meetings, etc.

Your letter also states that your sources of financial support will be from bingo games and rental fees. You plan to rent to non-profit organizations at a below fair market rental and/or to let some organizations use the facility without charge. You restate that you will not solicit financial support from the general public. You do not state that you will no longer be conducting the business of operating a banquet hall. The catering operation is continuing and ongoing and apparently remains your primary source of revenue.

Section 501(c)(3) of the Internal Revenue Code provides in part for the exemption from Federal income tax of organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated exclusively for one or more exempt purposes. An organization that fails to meet either the organizational or operational test is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its articles of organization limit its purposes to one or more exempt purposes; and do not expressly empower the organization to engage in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of the exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(e) of the regulations provides, in part, that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.

Section 513 of the Code defines "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of the charitable purposes constituting the basis for its exemption.

Section 513(f) of the Code exempts the income from certain bingo games from taxation as unrelated trade or business income. An examination of the legislative history of this section [House Report No. 95-1608 2nd Session, 1978-2 C.B. 395 (397)] indicates that although Congress meant to exclude the income from certain bingo games from the computation of unrelated business taxable income, it did not intend to imply that an organization whose primary activity was the conduct of bingo was exempt. Bingo remains an activity unrelated to exempt purposes and alone cannot support exemption under section 501(c)(3).

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from tax on the ground that all of its profits are payable to one or more organizations that are exempt under section 501(c)(3).

In Rev. Rul. 54-305, 1954-2 C.B. 127, the Internal Revenue Service held that a corporation organized and operated for the primary purpose of operating and maintaining a purchasing agency for the benefit of its otherwise unrelated tax exempt members was engaged in business activities that would be unrelated activities if carried on by any one of the tax-exempt organizations served and therefore was not entitled to exemption under the predecessor to section 501(c)(3).

Rev. Rul. 54-305 was based upon the ruling in Hospital Bureau of Standards & Supplies, Inc., a case that involved evaluation and purchase of necessary hospital supplies by an organization for hospitals which was subsequently lost by the Government in the Court of Claims. Hospital Bureau of Standards & Supplies, Inc. v. United States, 158 F. Supp. 560 (Ct. Cl. 1958). Although the Government did not apply for a writ of certiorari, the regulations under section 502 of the Code were subsequently amended as a result of that case in order to make it clear that a business organization could not be exempt if it was used by unrelated exempt organizations and was operated for the purpose of engaging in activities that would amount to the conduct of unrelated trade or business if carried on by the exempt organizations.

[REDACTED]

In Rev. Rul. 69-177, 1969-1 C.B. 150, an organization that manufactured and sold wood products was wholly owned by a tax exempt college. One of the primary purposes of the organization was to employ the students of the college to enable them to continue their education. A majority of the organization's employees were students of the college. However, student employment was not related to the curriculum of the college. The organization turned over the profits from its business to the college. The ruling concludes that the business of manufacturing and selling wood and metal products was not an educational activity because the college students were not employed for the purpose of receiving instruction or training, or improving or developing their capabilities. The ruling points out that although granting scholarships to enable needy students to obtain an education may be a charitable activity, if an organization engages in trade or business to obtain funds for scholarship purposes, it is not exempt merely because the profits are used for scholarships. The fact that the students receive funds to further their education in the form of compensation does not make the organization exempt. In addition, section 502 precluded exemption on the grounds that the profits from the business activities were paid over to the college.

In Rev. Rul. 73-164, 1973-1 C.B. 223, an organization was formed by a church to promote and provide financial support for the charitable programs of the church through the performance of certain printing functions and the production of income for church use. It sought to accomplish these objectives by printing religious materials for the church but also derived substantial profits from the operation of a commercial printing business. The publication functions performed for the church accounted for approximately 10 percent of the overall publishing activities of the organization. All of its profits were derived from the commercial printing business. All of the net income was paid to the church. The ruling holds that although the organization may be organized and operated exclusively for charitable purposes by virtue of the fact that the beneficial use of all of its assets was effectively dedicated to exclusively charitable objects, its only basis for qualifying in that respect, apart from the relatively insignificant amount of printing performed for the church, was that all of its profits were required to be paid to the church. Since the organization had no other significant charitable activity and its principal income producing activity was the conduct of a trade or business, the Service held that the organization was not exempt under section 501(c)(3) by virtue of section 502.

Rev. Rul. 64-182, 1964 (Part 1)-1 C.B. 186, describes an organization that derived its income principally from the rental of space in a large commercial office building that it owned, maintained, and operated. The ruling holds that the organization meets the primary purpose test of section 1.501(c)(3)-1(e) of the regulations because its charitable contributions are commensurate in scope with its financial resources and are in furtherance of its exempt function. The business conducted, the rental of real estate, is excluded from the definition of unrelated trade or business under section 513.

The basic principal to be derived from the above discussion is that organizations performing ordinary commercial services to raise funds for exempt organizations are not performing a charitable function and are not themselves exempt.

[REDACTED]

Your primary activity is the operation of a commercial banquet hall. You indicate that you purchased the hall out of bankruptcy and plan to operate it for the purpose of raising money to be used by the [REDACTED] and other charitable organizations. You continue to operate the hall as a full-time business. Although you plan to allow certain charitable organizations to use your facility without charge and plan to charge others less than market value in the future, you have not submitted any documentation to show that this is your primary purpose. You have not commenced any bingo activity.

The commercial operation of the banquet hall would be considered an unrelated trade or business under section 513 if carried on by the [REDACTED] or any other exempt organization you propose to fund. Although your goals are well intentioned, your activities serve no independent exempt purpose. We have concluded, after considering all the facts and circumstances, that the operation of the banquet hall in a commercial manner is your primary purpose based on the size and extent of the business and the fact that it has been and continues to be your primary activity and sole source of funds. Accordingly, we conclude that you do not meet the requirements for exemption under section 501(c)(3) of the Code. You do not operate a trade or business in furtherance of your exempt purposes as required by section 1.501(c)(3)-1(e) of the regulations, rather you operate the business for the sole purpose of making a profit and distributing it to one or more exempt organizations.

In this regard, you are similar to the organizations described in Rev. Ruls. 54-305, 69-177 and 73-164. Your only basis for exemption is that the beneficial use of your assets is effectively dedicated to charitable objects in that all your profits are to be used for charitable purposes. Exemption under section 501(c)(3) is precluded by virtue of section 502.

You are not similar to the organization described in Rev. Rul. 64-182 because the business you engage in is considered an "unrelated trade or business" under section 513. However, if you were engaged in another business as your primary activity, such as bingo, that is not an unrelated trade or business, you might still fail to qualify for exemption. Rev. Rul. 64-182 holds that the organization was furthering charitable purposes because its charitable contributions were commensurate in scope with its financial resources. To date, you have not made any charitable contributions from the revenue generated from your business. In addition, you state that you plan no contributions until such time as the business is profitable and all debt appropriately amortized. It is unlikely, under these facts and circumstances, that we would find your charitable giving program commensurate in scope with your resources and sufficient to support exemption under section 501(c)(3).

Your Articles of Incorporation also fail to satisfy the organizational test. Section 1.501(c)(3)-1(b)(1)(i) of the regulations precludes exemption unless an organization limits its purposes to those within section 501(c)(3). Your Charter expressly empowers you to operate a commercial business for the purpose of generating the net income for charity. This purpose is not considered a charitable purpose within the meaning of section 501(c)(3) and is specifically excluded from exemption by virtue of section 502.

Accordingly, we conclude that you are not organized and operated for charitable purposes within the meaning of section 501(c)(3) of the Code.

In the event we determined you were exempt under section 501(c)(3) of the Code, you asked to be classified as a non-private foundation under either section 509(a)(3) or 509(a)(2). You do not satisfy the requirements for classification under either section. For the following reasons, we would classify you as a private foundation described in section 509.

Section 509(a)(3) of the Code excludes from the definition of private foundation an organization which: (a) is organized and at all times thereafter is operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified public charities; (b) is operated, supervised, or controlled by or in connection with one or more specified public charities; and (c) is not controlled directly or indirectly by one or more disqualified persons other than foundation managers and other than one or more public charities.

Although you state that you were created to generate funds for the [REDACTED] your Articles of Incorporation do not limit your operations solely to benefit that or any other named charitable organization. In addition, you have indicated that your board of directors is not elected or appointed by the [REDACTED]. Since you meet neither the organizational or operational test and are not operated, supervised or controlled by or in connection with one or more specified public charities, we conclude that you are not described in section 509(a)(3) of the Code.

Section 509(a)(2) of the Code generally excludes from the definition of private foundation an organization that normally receives more than one-third of its support from any combination of gifts, grants, contributions, membership fees, and gross receipts from permitted sources, and not more than one-third of its support from gross investment income and the excess of the amount of unrelated business taxable income over the amount of taxes imposed by section 511. Since you have indicated that to date your sole source of support is from the operation of the banquet hall, an unrelated trade or business, you are not described in this paragraph.

Based on the above, we conclude that you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

[REDACTED]

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio EP/EO key district office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, EP/EO Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED] OP:E:EO:T:4, Rm. 6236
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

cc: [REDACTED]
[REDACTED]
[REDACTED]

OP:E:EO:T:4
[REDACTED]
7/29/99

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[REDACTED]
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